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March 12, 2003

President's Commission on the United States Postal Service
1120 Vermont Avenue, NW, Suite 971
Washington, D.C. 20005

**SUBJECT: REBUTTAL OF THE NATIONAL FEDERATION OF INDEPENDENT
BUSINESS'S LETTER CALLING FOR SUBSIDIZED SERVICES BY USPS**

The U.S. Business and Industry Council was founded in 1933 and represents hundreds of small and medium-sized enterprises, most engaged in manufacturing and most family owned, located across the country.

Our interest in the work of the President's Commission on the United States Postal Service stems from three main factors: (1) our members are large-scale users of the Post Office and of private shipping services, the latter being companies on which our members want to rely as they conduct their businesses; (2) greater USPS expansion into new lines of business, either directly or indirectly through USPS/private-sector partnerships, undercuts the formation of new private companies, thus harming the American economy; and (3) the shared philosophy of our members is deeply rooted in the principles of the private enterprise system, which could well be undermined by precedents set by the Commission that permit, encourage, or condone the use of subsidies.

The National Federation of Independent Business (NFIB) has argued for a wide range of subsidized services from the USPS. [See NFIB's Comments on the USPS Transformation Plan, in a letter dated Feb. 12, 2003.] As a general rule, NFIB apparently favors cross-subsidized services for its members, whether in rural areas, in package delivery, or in saturation mail advertising. In essence, NFIB's argument is that its members can't afford to pay the full costs of the various services they consume, so someone else should. This position is completely at odds with basic free-market, free-enterprise principles.

NFIB's contention that cross-subsidies for its small and micro business members enhance competition by allowing them to compete against larger firms stands free market logic on its head. It may be that business in today's globalized economy is "increasingly dominated by larger firms in many markets" and that smaller firms do not have the resources to compete with them. But there is competition among the larger firms themselves, bringing the public product

THE UNITED STATES BUSINESS AND INDUSTRY COUNCIL

910 16th ST NW STE 300 Washington, DC 20006 (202) 728-1980 COUNCIL@USBUSINESS.ORG

knowledge, efficiencies, and good prices. And if NFIB truly believes smaller firms cannot compete and should be assisted in doing so, then there are more appropriate venues than the USPS and postal policy to address this problem, including, *inter alia*, anti-trust policy.

The USPS was never intended to be a vehicle to correct perceived inequities in market power. Thus it is fanciful to say the least for NFIB to posit that “the role of the USPS in keeping rates modest so that this kind of saturation advertising be continued into the indefinite future is critical.”

When and by whom was the USPS appointed to monitor and modify competition with an eye toward the survival or profitability of NFIB’s small businesses? Certainly the Congress has not empowered the Post Office to intervene in the market in such a way. Further, interference in the marketplace by a government monopoly to favor a certain set of business owners is simply not contemplated by our free-enterprise system. In fact, such activity is inimical to that system and will end up destroying free enterprise.

We can agree with NFIB that raising first-class rates would impact both businesses and households, but someone has to pay for the service, whether it be the users of the service directly in the form of rate increases or whether it be businesses and individuals indirectly through revenue gained from taxing businesses, the general population, or both. And we are also in agreement there may be any number of steps that the USPS can take to improve efficiency and cut costs before raising first class rates, including straightening out its pension mess.

But we strongly disagree with NFIB’s suggestion that the USPS expand operations in non-first class mail markets even when “these services are provided by private companies” as an alternative to raising first-class postage rates. Any such expansion is a serious mistake. Cross-subsidization of other areas by revenues earned through the first-class mail monopoly would distort the market (though apparently benefiting NFIB’s members – at least in the short run). Over time subsidized competition by USPS would reduce the efficiencies produced by some very effective private companies. It would induce a “race to the bottom” as private companies were forced to cut prices and services in order to compete with the USPS’s artificial prices and cross-subsidized services. The end result would be a very inefficient and ineffective set of services, hurting the general economy by degrading the performance of American firms that are vitally dependent on these private services to compete both with one another and, increasingly, with foreign rivals.

Again, NFIB’s contention that having the USPS enter this market in a substantial way would increase competition and benefit the economy simply stands free market principles on their heads. NFIB’s understanding of the way markets work is exactly backwards. Subsidies induce inefficiencies and reduce competition, not vice versa.

In fact, contrary to NFIB’s suggestion, we believe that any attempt by the USPS to meet or beat competition by private firms is the very route likely to lead to higher first class rates. The pressure will be on the USPS – as the private firms respond to its market intrusions – to subsidize the expansion of operations in this highly competitive market area from funds raised in the first-

class mail delivery market, where they have a monopoly. The end result will likely be higher first-class rates to support other services that the USPS cannot perform as efficiently as the private sector.

USBIC is an organization of private companies. Our members create new companies and /or evolve their current businesses into new organizations addressing new needs and taking advantage of new technologies. We are enthusiastic about American entrepreneurs forming new businesses, which grow the economy and provide jobs to the American people. If a government-created monopoly like the USPS can move into any area of business that looks promising, then (a) it will have a chilling effect on the formation of new businesses in new lines of enterprise – because entrepreneurs will be reluctant to risk their capital, time, and talent to compete against a monopoly based organization; (b) the market will be precluded from regulating competition, employment, compensation, etc. in these new areas – instead the Postal Commission will decide outcomes; (c) the country and the economy will be deprived of effective and efficient businesses – since the USPS is unlikely to perform like private enterprises; and finally, (d) government at all levels is going to be deprived of revenue from the potential private companies – because they won't exist and the USPS doesn't pay taxes, which in turn means a higher tax burden on our businesses and on individuals.

In the Executive Order of December 11, 2002 which established the Commission, several points were laid out under the heading of “missions” to be examined. The U.S. Business and Industry Council believes that the most important of these missions is “(iv) the ability of the Postal Service, over the long term, to maintain universal mail delivery at affordable rates and cover its unfunded liabilities with minimum exposure to the American taxpayers.”

In addition, we are particularly concerned about point “(ii) the flexibility that the Postal Service should have to change prices, control costs, and adjust service in response to financial, competitive, or market pressures” – because of its implied focus on using its privileged position to take business away from the private sector.

This concern leads the U.S. Business and Industry Council to the conclusion that “(v) the extent to which postal monopoly restrictions continue to advance the public interest under evolving market conditions, and the extent to which the Postal Service competes with private sector services” will be the real center of debate as the Commission works to fulfill its charter. Of particular interest to us is the extent to which the Commission will reject special interest pleading, such as the comments offered by NFIB, and attempt to position the USPS so that it can fulfill its core responsibility without distorting markets and harming the free-enterprise system, which has brought about the economic greatness of the American nation.

The U.S. Postal Service has several advantages that are not available to private firms. The USPS has a government-granted monopoly in its main line of business, first-class mail. It is also exempt from all Federal, state, and local taxes, and can borrow money at interest rates lower than the market offers private firms. Make no mistake, these are very significant competitive advantages.

If these advantages are used to support a USPS focused on its primary mission, the universal delivery of letter mail, they can be justified on the basis of the USPS's performing a necessary public service. However, in an age of budget deficits, outsourcing, and privatization of services previously performed by government, we would not rule out exploration of whether any or all of the services performed by the USPS can be privatized. And certainly, where there are already private firms offering a service, the role of the USPS should not be expanded in that area.

Traditionally, the combination of the high fixed costs of a universal mail delivery system, the economies of scale that obtain once the system is established, and the importance of the service to the public led to the treatment of the USPS as a utility, with the rare privilege of a government-granted monopoly. As a monopoly, the USPS is regulated by government policy rather than by competitive market forces, which normally create the most efficient and effective ways to conduct a business.

There are several problems with monopoly power, including its tendency to become inefficient and its tendency to try to expand over time. Excess revenue earned under monopoly pricing can be used to subsidize entry into and then growth in other competitive venues, thereby giving the monopoly an unfair advantage against private firms that do not have a protected profit center and various subsidies backing up their operations. The over-allocation of first-class revenues to general USPS overhead implies this cross-subsidization is already well underway.

The USPS is clear in its intentions to pursue Negotiated Service Agreements and to transform itself into a Commercial Government Enterprise. These plans imply further use of this cross-subsidization practice to lower marginal costs on an increased volume of other, non-first class, delivery services in competition with private firms that must pay the full cost of doing business. The acceptance of cross-subsidization as a given is a very harmful principle to be established in any line of business in an economy and society that value private enterprise. The very concept implied in the term "commercial government enterprise" is suspect. It should be either commercial or government, but not both.

As the Commission engages in its important work examining the challenges facing the U.S. Postal Service and considering potential legislative and administrative solutions, the U.S. Business and Industry Council appreciates the chance to present the views of its members to the Commission. We thank you for your time and consideration. Please feel free to contact us if you have any questions or require additional information about our positions.

Sincerely,

Kevin L. Kearns
President

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